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IN THE

Supreme Court of the United States

A. ELLIOTT ARCHER AND CAROL A. ARCHER,
Petitioners,

v.

ARLENE L. WARNER,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF IN SUPPORT OF CERTIORARI

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In opposing the petition, respondent argues primarily that "factual nuances" between the decisions of the Fourth, Seventh, and Ninth Circuits, on the one hand, and those of the D.C. and Eleventh Circuits, on the other, might explain the divergent results reached in the cases on the question whether an otherwise nondischargeable debt becomes dischargeable if the parties enter into a settlement agreement resolving the amount of the debt. Opp. 6. The factual differences on which respondent relies, however, did not form any part of the basis for those courts' decisions. The only explanation for the divergent results is that the courts of appeals have interpreted Section 523(a) of the Bankruptcy Code differently. At bottom, it is inescapable that a different rule of law now governs in different courts of appeals. It is for this reason that the D.C. Circuit concluded that on "our

reading of those cases, ... they cannot be reconciled," *United States v. Spicer*, 57 F.3d 1152, 1156 (D.C. Cir. 1995) (Wald, J.). Indeed, the majority and dissenting judges on the Fourth Circuit below agree that the circuits are divided on the question presented. *See* Pet. App. 8a ("there is a split among the circuits concerning this issue") (majority); *Id.* at 11a-12a (contrasting "the approach of the Ninth and Seventh Circuits" with "the competing approach adopted by the D.C. and Eleventh Circuits") (Traxler, J., dissenting). Only this Court can resolve this conflict on an important and recurring question of federal bankruptcy law. Certiorari should therefore be granted.

I. THE CONFLICTING DECISIONS CANNOT BE RECONCILED ON THEIR FACTS.

Respondent acknowledges that the decisions of the courts of appeals "reflect a measure of confusion on the proper approach" to be applied when "a claimant in bankruptcy seeks to have an agreed settlement payment treated as nondischargeable." Opp. 6. In truth, there is more than "confusion." The circuit split is square, acknowledged and mature.

A. The Circuit Split Dates to 1983, When the Eleventh Circuit's Decision in *Greenberg* Split with the Seventh Circuit's Decision in *Maryland Casualty*.

It is true that the Seventh Circuit's decision in *In re West*, 22 F.3d 775 (7th Cir. 1994), sought to reconcile the Eleventh Circuit's decision in *Greenberg v. Schools*, 711 F.2d 152 (11th Cir. 1983), with the Seventh Circuit's own prior decision in *Maryland Casualty Co. v. Cushing*, 171 F.2d 257 (7th Cir. 1948), along the lines suggested here by respondent. Although the Eleventh Circuit's decision in *Greenberg* plainly stated that "a debt which originates from the debtor's fraud should not be discharged simply because the debtor entered into a settlement agreement," *Greenberg*,

711 F.2d at 156, the Seventh Circuit in *West* read that opinion more narrowly – to apply only to a set of facts that cannot be discerned from the face of the *Greenberg* decision itself. Specifically, the Seventh Circuit in *West* relied on the fact that in *Greenberg*, the state court fraud action was dismissed by stipulation, without the plaintiff expressly "releasing" the defendant from the settled claims. That fact, revealed only in the bankruptcy court opinion in *Greenberg*, is never mentioned by the Eleventh Circuit, and nothing in the Eleventh Circuit's decision suggests that the court intended its holding – that the "Bankruptcy Court should inquire into the factual circumstances behind the settlement agreement to ascertain whether or not the debt . . . was derived from the alleged fraudulent conduct" – to turn on the presence or absence of express "release" language in the settlement agreement. 711 F.2d at 156.

For this reason, the D.C. Circuit flatly rejected the Seventh Circuit's claim that the cases are reconcilable. "[W]hether or not the settlement in *Greenberg* included an express release or waiver, in our view that case stands for a broader principle: a fraudulent debtor may not escape nondischargeability, imposed as a matter of public policy by Congress in § 523(a)(2)(A), merely by altering the *form* of his debt through a settlement agreement. . . ." *Spicer*, 57 F.3d at 1156. Thus, the Eleventh Circuit's *Greenberg* decision "cannot be reconciled" with the Seventh Circuit's decisions. *Id.* Simply put, *Greenberg* and the various bankruptcy and district court opinions applying the same rule "meant what they said and said what they meant: a fraudulent debtor remains a fraudulent debtor, and debt originating in fraud remains nondischargeable even if its legal form changes under a settlement agreement." *Id.* at 1157.

B. Respondent's Effort To Reconcile the D.C. Circuit's Decision in *Spicer* with the Decisions of the Fourth, Seventh and Ninth Circuits Is Unavailing.

In addition to explaining that the Seventh and Eleventh Circuit approaches "cannot be reconciled," 57 F.3d at 1156, the D.C. Circuit's decision in *Spicer* itself squarely split with the Seventh Circuit's reasoning. Thus, even if it were possible to reconcile the Eleventh Circuit's decision in *Greenberg* with the decisions of the Seventh and Ninth Circuits, as respondent attempts to do, it cannot seriously be maintained that the D.C. Circuit's *Spicer* opinion can be harmonized with the cases it expressly rejects. In *Spicer*, the government's civil claims for fraud were "explicitly released" in exchange for the debtor's agreement to pay a specified amount. 57 F.3d at 1154. The D.C. Circuit squarely and expressly rejected the reasoning of the Seventh Circuit (also adopted by the Ninth Circuit). "We decline to follow the *Maryland Casualty* approach, however, because in our view it improperly elevates legal form over substance. We cannot agree with a rule under which, through the alchemy of a settlement agreement, a fraudulent debtor may transform himself into a nonfraudulent one, and thereby immunize himself from the strictures of § 523(a)(2)(A)." *Spicer*, 57 F.3d at 1155. By contrast, the court of appeals below did follow the reasoning set out in *Maryland Casualty* and similar cases, which it described as "the better reasoned decisions." Pet App. 8a.

Respondent accordingly does not even contend that *Spicer* can be explained away (as she would explain *Greenberg*) on the ground that the case did not involve an express release. Rather, respondent's argument is that *Spicer* is different because the debtor in that case had pled guilty to a criminal charge of fraud, whereas in this case "there has been no judicial finding of, or admission of, fraudulent conduct by Respondent." Opp. 9.

That "distinction" – which not even respondent contends formed any basis of the D.C. Circuit's decision in *Spicer* – misses the point altogether. The question presented is whether it is appropriate to look behind a settlement, and have the bankruptcy court make an independent determination whether the underlying debt is one for money obtained by means of fraud. Respondent's argument, that the bankruptcy court should be limited to considering "adjudicated or admitted fraud," is foreclosed by this Court's decision in *Brown v. Felsen*, 442 U.S. 127 (1979). In *Brown*, this Court held that in determining the dischargeability of a debt that has been reduced to a judgment, the bankruptcy court is not limited to reviewing only the pleadings and record in the prior decision. Rather, the bankruptcy court is itself "to make an accurate determination whether respondent in fact committed the deceit, fraud, and malicious conversion which petitioner alleges. . . . They are the type of question Congress intended that the bankruptcy court would resolve." *Brown*, 442 U.S. at 138. While respondent complains that the bankruptcy court should not "act, at a creditor's request, as a sort of inquisitor general," Opp. 4, this Court in *Brown* made clear that "Congress intended the fullest possible inquiry" into the question whether the underlying debt "aris[es] out of conduct" that the Bankruptcy Code specifies "should be excepted from discharge." *Brown*, 442 U.S. at 138.

In sum, any fair reading of the case law leads unavoidably to the conclusion that the different outcomes are a function of divergent constructions of Section 523(a) of the Bankruptcy Code, not "factual nuances," Opp. 6. That much is clear from the majority and dissenting opinions below, both of which expressly state that the circuit courts are divided on the question presented. "As noted by the district court, there is a split among the circuits concerning this issue. . . . We agree with the district court and the bankruptcy court that the better reasoned decisions are those of the Seventh and Ninth Circuits rather than those of the

District of Columbia and Eleventh Circuits." Pet App. 8a (majority). "There are two competing views to the main issue in this case. . . . The bankruptcy court adopted the approach of the Ninth and Seventh Circuits. . . . The competing approach [is] adopted by the D.C. and Eleventh Circuits." Pet App. 11a-12a (dissent). The circuit split identified in the petition is clear and sharp, and should be resolved by this Court.

II. THE DECISION BELOW IS INCORRECT.

A claim of fraud can take any number of forms: (1) some fraud claims will not have been liquidated to a specific amount (either by litigating to judgment or by settling) as of the date of bankruptcy filing; (2) some will have been litigated to judgment; and (3) others will have been litigated and settled. The first two categories of debt for money obtained by means of fraud are plainly excepted from the discharge. In both of these categories, the creditor bears the burden of proving to the bankruptcy court that the underlying debt is in fact for money obtained by means of fraud. The question presented by the petition is whether the third category must be treated differently, or whether the creditor should be given the same opportunity to prove that the source of the underlying debt was an act of fraud.

When a creditor has obtained a fraud judgment, it is undisputed that res judicata principles would preclude the creditor from contending that the amount of the debt is greater than is reflected in the judgment, or otherwise asserting claims against the debtor arising from the same transaction or occurrence. Despite this preclusive nature of the prior judgment, however, that creditor is of course permitted to take action to recover on that judgment (such as suing to enforce the judgment), including, according to *Brown*, proving to a bankruptcy court, with evidence beyond the four corners of the judgment and record itself, that the underlying source of the debt was an act of fraud by the

debtor, and that the debt is therefore excepted from the discharge.

The same consequences flow from a standard settlement and release. After settling a fraud action, the plaintiff cannot then continue to prosecute the existing action or initiate a different suit against the same defendant on account of the same conduct. But just as a judgment creditor can take appropriate action to recover on the judgment, including initiating a nondischargeability action in bankruptcy court, so too does a standard release (including the release at issue here) permit the plaintiff to bring action to obtain payment for the settlement amount. Consistent with *Brown*, the creditor may attempt to prove that the underlying source of the debt was an act of fraud.

In response to the argument that the rule that now controls in the Fourth, Seventh and Ninth Circuits will stand as an obstacle to settlement, respondent contends that a well-advised creditor may be able, by clever draftsmanship, to contract around the difficulties created by this rule. Even if that is correct, the construction of Section 523(a) that now controls in these courts of appeals lays a trap for the unwary.[1] As noted in the petition (and as respondent does not challenge), this trap would apply not only to creditors who

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[1] Respondent is incorrect to suggest that a creditor who settles a fraud claim with a defendant who thereafter files for bankruptcy will necessarily be able to assert a claim of fraud in the inducement. *See* Opp. 12-13. A party who intends to file for bankruptcy has no affirmative obligation to apprise one's creditors of that intention. Accordingly, absent a special relationship or an affirmative misrepresentation, the failure to disclose that intention will not generally give rise to a claim of fraud. *See Restatement (Second) Torts* § 551, cmt. a ("Unless he is under some one of the duties of disclosure [created by a special relationship or a prior representation], one party to a business transaction is not liable to the other for harm caused by his failure to disclose to the other facts of which he knows the other is ignorant and which he further knows the other, if he knew of them, would regard as material in determining his course of action in the transaction in question.").

have been the victims of fraud, but also those who are owed other nondischargeable debt such as alimony, child support, or amounts due on account of willful and malicious injury. *See* Pet. 13-14. There is no reason to believe that this is what Congress intended. There is certainly no reason why divergent rules of law should be applied in the different courts of appeals.

CONCLUSION

For the foregoing reasons, and those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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